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Coates, Francis

Standardized financial statements

Cleveland, Ohio

[1916]

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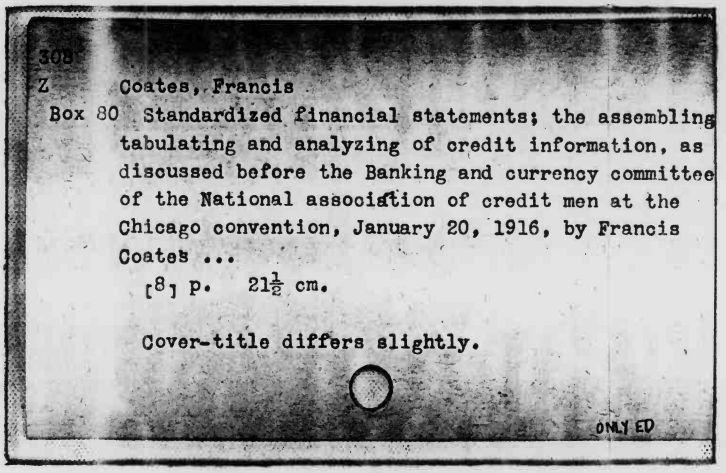
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Standardized Statements

The Problem
of the
Banker
and the
Business Man

Compliments of
The Cleveland Clearing House Association
Cleveland, Ohio

Standardized Financial Statements

The assembling, tabulating
and analyzing of
Credit Information

As discussed before the
Banking and Currency Committees
of the
National Association of Credit Men
at the
Chicago Convention
January 20, 1916

By
Francis Coates, Jr.
Examiner
Cleveland Clearing House Association
Cleveland, Ohio

Mr. Chairman and Gentlemen:

The subject "The Improvement of Credit Department Methods in Member and Reserve Banks" is so closely identified with the subject assigned to me, and both have been so fully and so ably covered by Mr. Martin that there appears to be but little room for further discussion. My only excuse for attempting to continue further is to point out a *concrete case of application.*

As shown by Mr. Martin, the Federal Reserve Banks took the initiative in *recommending* the use of standardized forms of financial statements. The advance step on the part of the banks (both member and non-member) in *actually working out a solution* was taken in my home city—Cleveland—and I shall take this as a basis for my discussion. We are confronted there with a condition—not a theory.

We all appreciate the causes that have led up to the establishment of departments of credit and analysis in practically every line of mercantile business and of banking; of utilizing financial statements as a basis for credit and credit analysis, and predicating our risks on the financial worth and the successful operations evidenced thereby.

Through the operation of our Clearing House Association in Cleveland, the necessity of *uniformity in assembling and tabulating* credit information *for* analysis, was deeply impressed upon each bank, and as a natural result, our efforts were finally turned to the only logical end, the adoption of a standard that *would* be used by all. Accordingly in August last we undertook the compiling of a set of financial statements that would be so used. Several meetings of the bankers were held, and as a result a set of four forms was finally decided upon: Corporation, Partnership, Individual (Manufacturing and Mercantile Lines) and Individual (Farmer or Layman) which were adopted and *are now used* by every bank in the community. This action was looked upon in many quarters as being rather an abrupt departure from conventional lines. In others it was misconstrued as a possible reflection on our past methods. One banker from one of the larger cities wrote in "I am glad to see that the Cleveland banks have at last decided to use statements. Some of the banks in this city have used them for some time." It is needless, of course, for me to say "so had we," to point out that it was only by reason of their advanced credit methods that the bankers of Cleveland had aspired to an ideal form to be used *as a standard by all,* and so, our action in adopting the standardized forms is probably my best response to the subjects "The Improvement of Credit

Department Methods in Member and Reserve Banks," and also for "Standardizing Financial Statements and Assembling, Tabulating and Analyzing Credit Information in Banks."

Competent departments of credit have not as yet been established in all of the Federal Reserve Banks. As in the case of St. Louis, the Federal Reserve Bank of Cleveland has also taken a long step forward. It requires its member banks to establish credit files on those borrowers whose paper is offered for rediscount, by insisting on signed financial statements of the current year's date on all loans of $2,500.00 or more, and has formally accepted the Cleveland Clearing House forms as standard. This with the result that many banks in the Cleveland Reserve District, outside of the city of Cleveland, have also adopted the forms as standard. These statements, originating in the member banks, are in turn incorporated into the files of the Reserve Bank as occasion requires, and so, automatically, the credit departments in both the Reserve Bank and the member banks are built up—and the building is along standardized lines.

The value of standardized forms is many fold. They are designed to meet the requirements of practically every line of business, and are so arranged that the bank's analytical and comparative records, covering years of operation, may be quickly drawn from the statements by any clerk and intelligently tabulated for analysis by the credit man. Each item and class of assets and of liabilities; each item in the distribution of profit and loss; each item in the reconcilement of surplus or net worth, and each response in the questionary, is in its own allotted space in every borrower's statement, and the continuing identity of the various items is insured in each succeeding statement from year to year.

(The requiring of a "reconcilement of surplus or net worth" is a feature of greatest importance to the credit man and accountant, but unfortunately is usually overlooked in compiling financial statement forms.)

The forms are uniform—both in the matter of tabulation, and in what is requested, or required, by every bank of every borrower. I say every borrower! I do not say that it is *furnished* by every borrower—as yet—but I believe, from our experience in Cleveland, the time is not far distant when every commercial borrower will come to the realization that he is best serving his own interests in making a comprehensive showing of his condition, and the result of his operations, to his banker.

In Cleveland, the action among the banks was unanimous. I might almost say it was unanimous on the part both of the bankers and the borrowers. This with the result that improved methods *have inured* to our Federal Reserve and member banks (and also non-member banks) through the use and adoption of standardized forms.

It has demonstrated its worth to the banker. Let us look at it from the borrower's standpoint.

We can readily realize its value to the successful dealer or operator—those who are up-to-date in systems of accountancy and credit in their own lines—in enabling them to secure freely the accommodation at bank to which their worth and successful operation entitles them; of the additional value its universal adoption would be to them in tending to limit or restrict, or even to eliminate, the unfair competition which is being fostered in many quarters by loans to unsuccessful, reckless, or unfair competitors who may now borrow without making competent statements, or whose statements are not submitted to the acid test of periodical analysis and verification.

Its merit is too obvious to necessitate discussion along these lines.

Let us look to the dealer or operator who is *not* securing the accommodation to which his worth and his success entitle him, who is handicapped by his inability, through ignorance or faulty methods, of compiling a competent statement. In the natural evolution attending the use, the tabulation and the analysis of statements—of the accounts of profit and loss—and the detail contained in the questionary, the services of the accountant, the auditor and the credit man are brought into play. In many instances it has been developed that a borrower could not make a statement, simply because he did not know how, or because his methods of accounting were at fault. He is successful, but he does not know the degree of his success or his actual financial condition. There are many such cases. The bank's accountant steps in and arranges this borrower's values in intelligent lines, or the bank's auditor is called upon to take inventory, and to make his figures for him and, incidentally, in case the connection is a desirable one, to install a system of accounting and operation that will not only demonstrate the present, but insure the future worth of the business, with the result that a valuable connection is secured to both the banker and the borrower. To this end, several of our banks are operating departments of accounts and audit for the use of their clients, but for their mutual good and protection.

During 1915 a nation wide movement of this form of advancement and education was considered; a

natural result of the initiative forced upon the banks by their adoption of necessary standards. The Federal Trade Commission, recognizing the necessity of intelligent action looking upon a closer relationship between the business man and the banks, undertook two constructive methods of advance. I quote in part from the statement of Mr. Edward N. Hurley, Vice-Chairman of the Commission, as follows:

"Among the several methods by which the Federal Trade Commission can be of constructive help to American business, there are two of particular importance; one of these is to aid the business men of the country in obtaining the additional credits to which their business operations may entitle them. The second is to aid in establishing a standard system of bookkeeping and cost accounting. The two are interdependent."

"The small manufacturer, the country storekeeper, and the retail merchant, as a rule, do not get at the banks, credit that they ought to receive, owing to the fact that they are unable to present balance sheets in accordance with good business practice. These men are just as good business men, in many respects, as those of larger operations. They have brains, ability, knowledge of their wares and of their customers, but they do not speak the language of the banker in that they are not able to present a statement showing their true assets and liabilities."

"Frequently a business man with a credit of a few hundred dollars at his bank, based wholly on personal grounds, could, if he could produce a reliable balance sheet, readily obtain several thousand dollars, which would enable him to expand his business along sound lines. Failing to obtain it, his business is limited and confined."

"Ability to borrow at the bank has a far-reaching effect on all credit because to the bank, primarily, are directed inquiries for a rating of a manufacturer or merchant seeking credits for goods. An unfavorable or non-committal report from the bank results in a curtailment of opportunity. It also checks expansion."

"Bankers are in business to loan money to business men, and recognize that loans made on balance sheets that are found sound are desirable loans. The banker will welcome any standard form a statement that will permit him easily to ascertain the exact liabilities and assets of his customers."

The large dealer, the jobber, is the banker in a measure to the retailer, his customer. He does not loan him bank credit, but he does loan him merchandise credit. The basis for this credit in the past was largely hearsay information as to character, responsibility and fair dealing, supported in some instances by an oral statement of the borrower as to his probable worth. Through the initiative of the Credit Men's Association the trend in recent years is the same trend as in the banking business, a showing as to condition—a signed financial statement. Not quite so strong a trend as in banking, but still a trend, and this trend is being steadily strengthened. The operation of our Federal Reserve Banks is in this direction. The preferential rate of discount accorded trade acceptances (a saving of one-half of one per cent), and the fact that the Federal Reserve Banks may purchase them in the open market will, without doubt, eventually convert a large portion of the jobbers accounts and bills receivable into acceptances, and his bills payable into rediscounts (a contingent liability). This will undoubtedly necessitate a financial statement being filed with the jobber by the retailer, in order that his paper may be eligible to rediscount with, or sale to, the Federal Reserve Bank. Shall this statement be haphazard in form, or shall it conform to the requirements of the purchaser (the Federal Reserve Bank), and in turn to the requirements of the member or non-member bank—of the jobber, and so down the line to the maker? Is not a standardized form the logical solution?

That it is working out along these lines in the Cleveland territory is demonstrated by the fact that our standardized forms are now being adopted by some of the larger jobbers and brokers (we have distributed some 300,000 forms) and it accordingly appears to me that our question is now, or soon will be, put up to the credit man—yourselves gentlemen, in your various lines of business, for its solution.

One other point, and that is the many large lines of so-called "commercial paper" or "brokers paper" which are being handled by the banks throughout the country. Many of the most disastrous failures during recent years are attributable to an incorrect or false showing as to liability for bills payable, on the part of the borrowers. As a matter of protection to the banker and also to the honest and successful dealer and operator, as against the operations of the dishon-

est or unsuccessful one, it would appear that the issuance of this paper should be *definitely controlled or safeguarded,* and this could probably be best accomplished by requiring the registration of all notes with some responsible registrar—Trust Company or Bank or Clearing House Association—in order that a verified statement of such liability could at all times be available to the purchaser. This is a subject that has been widely discussed by bankers, and is one, I believe, that might well merit the careful consideration of credit men, looking to their ultimate co-operation with the bankers, for their mutual protection.

NOTE.—Sample copies of the standardized forms of financial statements will be furnished on request. Postage 6 cents.

CLEVELAND CLEARING HOUSE ASSOCIATION,
Cleveland, Ohio.

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